BANKING AND BANK RUNS

1. WHY THE STANDARD LOAN CONTRACT?

- Moral hazard
- Costly monitoring

2. WHY LIQUID, OR FIXED-TERM, DEPOSITS?

- Moral hazard
- Costly monitoring

3. BANKS

- SLC's in both directions.
- Balance sheet mismatch
- Bank capital

4. BANK RUNS

- The logic for the individual depositor
- Contagion

5. WILDCAT BANKING

- Why it arises

6. IS THERE A PROBLEM?

- The world is full of risks, needs to gather information.
- Are these banking and lending problems specially deserving of regulatory intervention?

7. MAIN TYPES OF REGULATION OR INTERVENTION

- Bank examiners
- Deposit insurance
- Insurance $\Rightarrow$ examiners, perhaps not $\Leftarrow$.
- Lender of last resort
- Deposit rate ceilings
- Limitations on bank portfolios (Reserve requirements, mortgage specialty)

8. INCENTIVE PROBLEMS WITH REGULATION

- Bank examination, publication of results, reduces private incentives to investigate and assess bank soundness.
- Deposit insurance further reduces private incentives to investigate, and makes it optimal for bank management and depositors jointly to take on risk, at the expense of insurors.
- Lender of last resort function may encourage risk-taking.

9. SYSTEMIC RISK, EXTERNALITIES

- If default simply instantly and costlessly reallocated wealth, it could be argued that regulation and intervention is not needed.
- But in fact default is not instant and costless.
    - It can disrupt trading at a minute-by-minute or daily level.
    - It can tie up resources inefficiently for years, using lawyers and judges rather than markets to make resource allocation decisions.
    - Zombie companies, banks that support them.

10. EXAMPLES OF PROLONGED BANK CRISES

- US S&L — an effect of *de*regulation?
- Japan
- Mexico?
- Indonesia?

11. DOES ANY OF THIS APPLY TO HEDGE FUNDS?

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